

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

In the Matter of

Universal Service Federal-State
Joint Board's Second Recommended
Decision

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CC Docket 96-45
DA 98-2410

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

REPLY COMMENTS OF GTE

Dated: January 13, 1999

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domestic telephone operating companies

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REPLY COMMENTS OF GTE

GTE Service Corporation and its designated affiliated domestic companies¹ (collectively, "GTE") respectfully respond² to the comments filed on the Joint Board's Second Recommended Decision.³

¹ These comments are filed on behalf of GTE's affiliated domestic telephone operating companies, GTE Wireless Incorporated, and GTE Communications Corporation. GTE's domestic telephone operating companies are: GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., and Contel of the South, Inc.

² GTE offers these Comments without prejudice its positions set forth with respect to the pending petitions for review of the Commission's universal service order. *Texas Office of Public Utility Counsel v. F.C.C.*, No. 97-60421 (5th Cir.).

³ Federal-State Joint Board on Universal Service, Second Recommended Decision, CC Docket No. 96-45, FCC 98J-7 (released November 25, 1998) ("Second Recommended Decision").

I. INTRODUCTION AND SUMMARY

The Recommended Decision provides only very broad guidance to the Commission concerning the structure of the federal universal service plan. Further, the effects of any given funding calculation cannot be evaluated because the Commission has not yet completed work on its cost model. The Commission should adopt a final version of the cost model, together with the necessary inputs, and should make them public. The Commission should also develop one or more "strawman" options to illustrate how the framework contemplated by the Joint Board would actually work. The Commission should then provide parties with a further opportunity to comment on the funding proposals.

The Commission should move forward to replace the implicit support currently generated by interstate access charges with an explicit funding mechanism. Replacement of implicit support is necessary to preserve universal service, to promote efficient competitive entry, and to meet the clear requirements of the Telecommunications Act. The new mechanism to replace implicit support from interstate access should be implemented in July 1999, together with the other components of the new federal universal service plan for non-rural carriers.

The Commission should also ensure that it provides sufficient funding to carriers in states where additional resources are needed to maintain affordable and comparable rates. This will necessarily involve some increase over the current level of explicit funding. While this component of the funding may be calculated on a study area basis, all of the support from the new federal mechanism should be distributed to carriers on a geographically deaveraged basis.

Contributions to the new federal universal service mechanisms should be determined on the basis of combined state and interstate retail revenues. Each carrier should be able to recover its contributions to the federal mechanisms from its retail customers using a separate line item for that purpose. GTE believes that it is reasonable to limit this end-user recovery to an amount no greater than the carrier's contribution rate, as the Joint Board suggests. Concerns raised by this proposal can be addressed by improving the administration of the fund, and by ensuring that the revenue base for carrier contributions is the same as the base on which carriers are allowed to recover those contributions.

II. THE COMMISSION SHOULD SEEK ADDITIONAL COMMENTS AFTER IT HAS FINALIZED ITS COST MODEL, AND AFTER IT HAS FURTHER SPECIFIED ITS OPTIONS FOR THE FEDERAL UNIVERSAL SERVICE PLAN.

The Recommended Decision provides only very broad guidance to the Commission concerning the structure of the federal universal service plan. Almost all of the specifics are left to the Commission. As many parties have noted in their comments, it is difficult to comment on proposals that are still too vague to be evaluated in any detail.⁴ Similarly, the Recommended Decision proposes that the Commission should rely for some purposes on estimates of forward-looking cost, but the Commission has yet to complete work on its cost model, or on the inputs for that model. Even if parties had specific proposals before them, they would be unable to determine the overall size of the fund, or the support that would be provided to any given area

⁴ SBC at 1, Colorado at 1, Ohio at 3, MCI at 2, District of Columbia at 6.

under those proposals, because the cost estimates on which the proposal would rely are not yet available.⁵

GTE agrees with the many commenters who have expressed concern about their inability, under these circumstances, to fully evaluate the Joint Board's proposals, or to provide specific comments to the Commission as to the structure or the parameters of the universal service mechanism.

The Commission should move ahead to complete its forward-looking cost model, together with the necessary inputs, so that parties have access to the model and can produce cost estimates using the model. The Commission should also develop one or more "strawman" proposals to illustrate how the framework contemplated by the Joint Board would actually work. The Commission should then seek comment on the "strawman" funding proposals. This process is necessary to allow all interested parties to comment on the proposed non-rural universal service mechanism in a meaningful way.⁶

III. THE FEDERAL AND STATE PLANS MUST REPLACE IMPLICIT SUBSIDIES.

The Recommended Decision recognizes that most universal service support today is generated through a system of implicit support flows that have been built into the rates of incumbent local exchange companies ("ILECS") through the regulatory

⁵ Joint State Commissions at 14, Colorado at 1, Rural States at 2, SBC at 3.

⁶ See, e.g., District of Columbia at 7-8: "Therefore the FCC should provide another opportunity for comment after the model has generated the forward looking cost for each State, and before it implements changes in the current funding mechanism."

process. While the Recommended Decision could provide a framework for replacing those implicit subsidies, through a combination of state and federal mechanisms, the Joint Board does not specifically propose that the FCC and the states must take prompt action to do so. As a matter of law and policy, any universal service funding mechanism must assure that any support is made explicit.

A. Replacing Implicit Support Is Necessary to Protect Universal Service and to Promote Efficient Competitive Entry Into Local Markets.

As GTE explained in its Comments, there are overwhelming policy reasons for replacing implicit support with explicit, portable universal service funding.⁷ Explicit funding is needed to make universal service sustainable, to allow ILECs to compete fairly by unburdening ILEC rates that generate implicit support today, and, most importantly, to allow efficient competitive entry. As Sprint points out, leaving implicit support in place "encourages uneconomic entry in areas that supply the implicit subsidies, i.e., low cost areas, and discourages entry in areas that receive subsidies, i.e., high cost areas."⁸ MCI agrees that "(i)t is essential that the Commission fully implement all the Universal Service requirements laid out in the Act if Congress' overall goal of promoting competition in all telecommunications markets is to be met."⁹ A "wait

⁷ GTE at 4.

⁸ Sprint at 6-7. Of course, the existing implicit support also flows from one customer to another within a given area – from business to residence, from high volume to low volume – so that the distortions of customer choices and of entry decisions are not only between high and low cost areas.

⁹ MCI at 1.

and see" approach will simply not allow the Commission to meet its policy goals of preserving universal service while promoting efficient competition.

Those parties who advise the Commission to maintain the current system of implicit subsidies as long as possible¹⁰ are therefore wrong as a matter of policy. Many commenters note that local rates are generally affordable today, as if that were sufficient justification for retaining the implicit subsidy system that has made those local rates possible.¹⁰ The point of universal service reform is not to make local rates still lower than they already are, but to replace the current implicit support mechanism with explicit support that is more efficient, more fair, and more sustainable, and that will provide a sound basis for competition to develop. The Commission cannot expect to preserve universal service on a "wait and see" basis, because it will not be able to track the erosion of implicit support and respond to that development in a timely manner. It cannot expect to promote competition because it will be maintaining price signals that are preempting entry into many local markets. The "wait and see" approach thus runs the risk of becoming a self-fulfilling prophecy: competition does not develop because we do not correct the price signals, and we do not correct the price signals because competition does not develop. Several commenters emphasize the importance of

¹⁰ Joint State Commissions at 5, Ameritech at 7. Ameritech compares local rates from different areas around the country, but it does not examine the rates for state access, toll, business, and vertical services that are necessary to support the local rates it presents.

making universal service support portable among competing carriers, but the current support, as long as it remains implicit, can never be made portable.

B. Replacing Implicit Support Is Necessary To Satisfy The Requirements Of The 1996 Act.

Maintaining implicit support is also wrong as a matter of law. Several parties suggest that the Act does not require that support be made explicit.¹¹ GTE agrees with MCI that “(t)he Act is very clear that explicit Universal Service funding be created to replace implicit Universal Service funding.”¹² Implicit support that is subject to competitive erosion, and that might be replaced at some unknown time in the future, on some basis as yet undetermined, is not “predictable.” And as long as implicit support is generated by ILEC rates, and not by other carriers, the requirement that all carriers shall contribute on an equitable and nondiscriminatory basis will not be met.¹³ The requirements of the Act can only be met by replacing the current implicit support with an explicit mechanism.

Further, there are no conditions on the requirements of Section 254. As Sprint observes, “the Joint Board appears to suggest that the ILECs possess some burden to prove the existence of competition before implicit subsidies can or will be addressed by regulators. The Act contains no such test.”¹⁴ Similarly, the Rural States say that it is

¹¹ Joint State Commissions at 6.

¹² MCI at 5.

¹³ GTE at 7 and 14-15.

¹⁴ Sprint at 6.

incorrect to infer “that the requirements of Section 254 are predicated on the development of local competition. On the contrary, Section 254 of the Act simply and unconditionally requires a sufficient universal service fund...”¹⁵

AT&T suggests that the non-rural ILECs should not receive any payments under the universal service mechanism because, in AT&T’s view, these carriers have not opened their markets sufficiently to competition.¹⁶ AT&T is manufacturing a condition which is not found anywhere in Section 254. While the Act certainly requires the opening of local markets, Section 254 does not require that universal service support be dependent on such a condition.¹⁷ Similarly, AT&T’s suggestion that ILECs should not receive funds because they “generally have sufficient funds to support their own high cost needs”¹⁸ is totally unsupported by Section 254. Requiring ILECs to support universal service from “their own funds” does not meet the requirement of Section 254 that all carriers shall contribute to universal service on an equitable and non-discriminatory basis.

The Joint State Commissions, citing a Senate report, suggests that the 1996 Act “does not require the FCC to adopt a program that requires the level of high cost universal service support to become more expensive and burdensome to unsubsidized

¹⁵ Rural States at 6.

¹⁶ AT&T at fn. 2.

¹⁷ Of course, GTE believes that it has fully complied with all of the requirements of the Act.

¹⁸ AT&T at fn. 2.

ratepayers than it is today.”¹⁹ First, the 1996 Act itself contains no limit on the funding needed to accomplish the goals of Section 254. Clearly Section 254 exists because Congress believed that some explicit funding was needed beyond the current status quo. Second, and perhaps most important, no one has suggested that the total amount of funding needed is greater than that being supplied today through a combination of explicit and implicit mechanisms. Replacing implicit support with explicit universal service funding need not impose any additional burdens on ratepayers; indeed, by making universal service funding more efficient, the total burden – including efficiency losses – can be reduced. GTE has always supported the principle that any increase in the explicit universal service funding received by an ILEC should be offset by reductions in the rates that are generating implicit support today. In its Comments, GTE demonstrated that the replacement of current implicit support in interstate switched access would not harm local residence wireline customers, regardless of their income or usage levels.²⁰

C. The Commission Should Act Promptly To Replace Implicit Support In Interstate Access.

The Joint Board’s recommendation would give primary responsibility to each regulator – the FCC and each state commission -- to deal with implicit subsidies

¹⁹ Joint State Commissions at fn. 9.

²⁰ GTE discussed a study performed by USTA, which examined the effect of universal service reform on the actual monthly bills of residence customers in a nationwide sample. The study is described in greater detail in an attachment to USTA’s comments.

provided by rates within its own jurisdiction. Of course, only the FCC can address implicit subsidies generated by interstate access rates. GTE agrees with MCI that interstate implicit support must be replaced by explicit funding in a timely fashion.²¹ However, MCI is mistaken in assuming that the Joint Board recommendation somehow implies that the FCC's effort to address implicit interstate support should come only after the new federal fund has been established.²² The Joint Board makes no such proposal; it would be entirely consistent with the Recommended Decision for the Commission to take action to replace interstate implicit support when it implements its new non-rural plan in July 1999, and GTE urges the Commission to do so.

There are two components of the federal funding that would be provided under the Joint Board proposal. The first component would replace the implicit support from interstate access, as discussed above. The second component would provide funding to states where additional resources are needed to maintain affordable and comparable rates. Since, as many commenters recognize, local rates are generally affordable and comparable today, the purpose of this funding would be to replace the implicit support provided by intrastate rates which makes those local rates possible. The Joint Board recommends that this second component of the funding should be provided directly to carriers. GTE agrees with MCI that any increase in explicit federal funding for the first component of the federal mechanism – the portion of the fund intended to replace implicit interstate support – should be applied dollar-for-dollar toward offsetting

²¹ MCI at 5.

²² *Id.* at 4.

reductions in interstate rates.²³ However, MCI suggests that the funding for the second component of the federal fund – the portion of the fund that supports comparable state rates – should also be applied toward reductions in interstate access rates.²⁴ This is not possible, because the same dollar of funding cannot be used for two different purposes.²⁵ If funding is provided to a carrier through the second component of the federal fund, its purpose is to replace implicit support from intrastate rates, not interstate access. However, it would be reasonable for the FCC to require that, for every dollar of new, additional funding provided to a carrier under the second component of the federal plan, that carrier should make offsetting reductions in intrastate access that provide implicit support today.²⁶ GTE also agrees that this funding should not be used for any

²³ In general, these would be reductions in interstate access rates. Note, however, that under Rogerson's proposal some of the funding would be used to replace implicit support provided today by interstate end user charges, by reducing SLCs – especially multiline business SLCs – in low cost areas.

²⁴ *Id.* at 14.

²⁵ The Commission made precisely this mistake in its Universal Service Order last May, in which it required ILECs to apply their current high cost funding toward reductions in interstate access, ignoring the fact that these funds had already been used at the state level to hold down intrastate rates.

²⁶ AT&T suggests, at 9, that all such reductions should be made to intrastate access rates. GTE agrees that intrastate access is one of the sources of implicit subsidy at the state level, but it is not the only one. Intrastate rates for toll, business services, and vertical services also generate implicit support. GTE believes that, if it imposes a requirement for offsetting intrastate reductions, the FCC should allow ILECs and their state regulators discretion to determine the specifics of the reductions, and should require only that they be made to rates that generate support, not to the local rates that are already supported. It is also important to note that this adjustment should be made only once, when the fund is implemented. Year-to-year changes in the funding received by an ILEC may simply reflect changes in portable support as the carrier gains or loses local customers.

other purpose, such as funding infrastructure projects. USTA has proposed that the implicit support provided today by the interstate CCL and PICC charges should be replaced by explicit federal universal service funding. GTE supports the USTA plan.²⁷ In its Comments, GTE explained that the CCL and PICC charges are the support mechanisms that allow the interstate SLC to be capped at an affordable level, especially for residential subscribers.²⁸ In a recent paper, William Rogerson, the Commission's Chief Economist, has recently proposed that this implicit support mechanism for affordable SLCs should be replaced by an explicit funding mechanism.²⁹ Rogerson proposes that a set of deaveraged SLC charges should be calculated. The total revenue that would be raised by these deaveraged SLCs would equal the current interstate common line recovery permitted for the study area under the Commission's current price cap rules. The relative levels of the deaveraged SLCs would reflect the relative cost estimates produced by the forward-looking cost model for geographic areas within the study area. Rogerson proposes that the Commission would then choose the "affordable" level above which the SLC would not be permitted to rise (this could be the level of the current SLC cap.) In areas where the deaveraged, cost-based SLC charge is less than this cap, the SLC would be reduced to the deaveraged level.

²⁷ GTE also notes that some implicit support is generated today by the interstate access rates for switching and transport. These amounts, which are not addressed by the USTA proposal, should also be considered by the Commission.

²⁸ GTE at 8-10.

²⁹ Rogerson, William. A Proposal for Universal Service and Access Reform, December 9, 1998. See also Washington Telecom Newswire, January 4, 1999, "Comission Considers New Approach to Reform Access Charge System."

In geographic areas within the study area where the deaveraged SLC is greater than the affordable SLC level, the SLC would be capped at that level, and the difference between the deaveraged SLC and the capped SLC would be funded by the new federal universal service mechanism. Because the funding now provided by the CCL and PICC charges would be replaced by this new mechanism, these charges would be eliminated; this would provide the dollar-for-dollar reduction in interstate access charges to offset the new explicit universal service support.³⁰ Once the new support amounts are in place, they would be portable to other eligible carriers in the area meeting the conditions for the receipt of support.

GTE believes that Rogerson's proposal merits serious consideration. It is consistent with the USTA proposal, and with GTE's recommendations. It deals with the issue of the implicit support in access as a pricing matter – the mechanism needed to maintain the SLC at an affordable level – entirely within the Commission's ratemaking authority. GTE suggests that this framework should be part of the "strawman" proposal that the Commission should set for further comment when its cost model is complete.

D. States Must Act To Replace The Implicit Support Provided By Intrastate Rates.

Today, the largest single source of universal service support is the implicit support flow generated by intrastate rates for services such as access, toll, business lines, and vertical services. The Recommended Decision leaves to state commissions

³⁰ Note that the amount of support produced by Rogerson's calculation could differ from the current CCL and PICC revenue to the extent that the current SLC charge is reduced from its current level in low cost portions of the study area.

the primary responsibility for replacing these support flows with an explicit funding mechanism. GTE agrees with Sprint that the requirements of Section 254 can only be satisfied by making this support explicit.³¹ Sprint is concerned that the Recommended Decision is “peppered with messages to the states suggesting that they are not required to take action on universal service or intrastate implicit subsidies.”³²

GTE is skeptical that states can and will take sufficient steps to perform the role the Joint Board envisions for them. The Commission can increase the likelihood of an outcome that meets the requirements of the 1996 Act by ensuring that states have comparable resources available to them to discharge their universal service responsibilities. As the Rural States explain, this will certainly involve some increase in the amount of federal funding provided to non-rural study areas in high cost states.³³ In any event, the FCC can hardly expect states to step up to their responsibilities if it shrinks from its own.

As GTE explained in its Comments, and as the Commission itself acknowledged in its Report to Congress, the Commission retains a plenary responsibility to ensure that the combined effects of both federal and state actions on universal service are sufficient

³¹ Sprint at 5. GTE explained in its Comments (at 13-14) why states must take action. Of course, a state has the ability to mitigate the need for any kind of universal service funding by rebalancing its rates. GTE believes that in many states local rates may be increased without endangering affordability or comparability.

³² Sprint at 6.

³³ Rural States at 7. See also RTC at 9.

to meet the requirements of the 1996 Act.³⁴ Therefore, even if the Commission, following the recommendation of the Joint Board, initially adopts a plan that relies primarily on the states to address their own implicit subsidies, the Commission must carefully monitor the effectiveness of this approach once the plan is implemented. If the states do not take effective steps to replace their own implicit support flows, then the Commission must consider what additional measures it may need to adopt to discharge its plenary responsibility.³⁵

IV. UNIVERSAL SERVICE FUNDING SHOULD BE DISTRIBUTED ON A DEAVERAGED BASIS.

The Recommended Decision proposes that, at least initially, the support provided from the federal plan to states to maintain comparability of rates should be calculated on a study area basis.³⁶ Commenters were sharply divided over the propriety of basing support on such a large geographic area.

However, in making its recommendation, the Joint Board did not say that a comparison of average cost at the study area level would provide a reasonable measure of the overall need for universal service funding there. Indeed, as GTE has shown in its comments, it does not provide such a measure. The Recommended

³⁴ GTE at 15-16.

³⁵ See, for example, RTC at 11. GTE does not agree with RTC that the federal fund must be sufficient, and that no state effort can be assumed. However, GTE agrees that the FCC is ultimately responsible for the combined effect of state and federal action.

³⁶ Recommended Decision at ¶32.

Decision also does not say that the federal support provided to each study area must be distributed in a uniform way, so that every line in the study area receives the same support. Further, since the Recommended Decision leaves the replacement of implicit support from interstate rates to the FCC, the Joint Board does not make any recommendation as to how the explicit funding that replaces interstate implicit support should be distributed geographically.

The Recommended Decision focuses on the comparability of rates, and on the resources the federal fund must provide in order to put states on a more equal footing. The Joint Board recommends only that this determination be made on a study area basis. This reflects the Joint Board's assumption that, given an average level of cost, each state can require contributions from its own low cost subscribers to subsidize its high cost ones. As GTE showed in its Comments, the comparison of averages contemplated in the Recommended Decision does not measure how much support would be needed within a given study area, nor will it necessarily ensure that each state has the ability to maintain comparable, affordable rates.³⁷ Nonetheless, if the determination of the federal supplement to the state's resources is made in this average

³⁷ GTE at 21-22. Even if the federal plan were sufficient to equalize the mean cost across study areas, an area with a higher variance in cost will have to raise and distribute more support than one with a low variance. Consider two study areas, each with a mean cost of \$30. Suppose also that a \$30 rate is considered affordable. If all of the customers in study area A have the same cost of \$30, then no explicit funding will be required to maintain a \$30 rate. But, if in study area B half the customers cost \$15, and the other half cost \$45, then a significant transfer of funds will be required to support a \$30 rate. In principle, both A and B should be able to achieve comparable rates, but the political acceptability of a transfer on the scale needed in B may limit that state's ability to achieve the same rate as A in its higher cost areas.

fashion, as the Joint Board suggests, there is no reason why this component of the federal support should actually be distributed on an average basis.

Many parties explain in their comments why the distribution of support on a study area average basis would be unreasonable. Ohio, for example, points out that:

“(p)roviding federal support to every line in the study area, instead of targeting the support to only the high cost areas, could encourage uneconomic competition in the urban area and discourage competition in the rural areas. The competitor could serve only the urban area and receive federal support for lines that are low cost lines and should not require support. The support provided for the highest cost areas will not be sufficient and will discourage competitors from serving the rural areas. The incumbent local exchange company serving the entire study area with average rates will lose the customers in the urban areas that are providing support for high cost rural loops.”³⁸

As Ohio also points out, the state commission cannot undo the negative effects of averaged federal funding, because, under the Joint Board recommendation, support would be distributed directly by the federal fund to the carriers. GTE agrees with the recommendation to distribute funding directly to carriers, rather than as a “block grant” to the state, but urges the Commission to deaverage the support amount across small geographic areas within the study area. Several parties also note that the distribution of support on a study area basis would complicate the state’s efforts to designate a reasonable minimum serving area for prospective competitive local exchange carriers (“CLECs”). If a state attempts to avoid the problem discussed by Ohio by requiring a CLEC to serve the entire study area, it will create an unnecessary barrier to entry. If it allows CLECs to become eligible by serving only the low-cost

³⁸ Ohio at 2-3. See also MCI at 10, Sprint at 9, RTC at 22, GSA at 10-11.

portion of the study area, it will create unreasonable cherry-picking opportunities for the CLEC.³⁹

The Recommended Decision itself recognizes that support should be targeted to higher cost portions of the study area.⁴⁰ It suggests that the Commission could simply require a carrier to apply the funding it receives to higher cost areas. This remedy is impractical, first, because it does nothing to correct the price signals the carrier faces, and could never be enforced. Second, as RTC points out, the CLEC might not have any high cost customers: "the highest cost parts of the CLEC's service area may not be within the high cost parts of the ILEC's study area at all...(r)equirements for the CLEC that gets the support to target it to its highest cost customers would do nothing to put the support back in the hands of the carrier whose facilities serve the above average cost customers."⁴¹

Even if the Commission decides to base the amount of support provided to each study area on an average cost calculation, it should develop a method for apportioning this support on a deaveraged basis to smaller geographic areas within the study area. For this purpose, the cost model could be used to provide estimates of the relative costs of these small areas. This is the only practical way to achieve the targeting which the Joint Board itself acknowledges to be necessary. While such a deaveraged distribution of support is entirely consistent with the Recommended Decision, the Joint

³⁹ Sprint at 9, RTC at 22.

⁴⁰ Recommended Decision at ¶58.

⁴¹ RTC at 23.

Board does not provide any guidance to the Commission as to how the deaveraging should be done. GTE suggests that the Commission should propose a specific method for the distribution of support within each study area as part of the "strawman" proposal it sets out for further comment.

A. The Explicit Federal Funding That Replaces Implicit Support From Interstate Access Should Also Be Deaveraged.

With respect to the replacement of the implicit support provided today by interstate access charges, the Rogerson proposal, described above, provides a basis for calculating new explicit funding to replace the support provided today by the CCL and PICC charges. This support would be geographically deaveraged by the nature of Rogerson's calculation. However, GTE is concerned that the Rogerson proposal, at least as discussed to date, allows for a limited number of geographic zones within each study area. If the number of zones is insufficient to capture the cost variation within the study area, there may be an unreasonable amount of averaging within each zone.

V. THE AMOUNT OF FEDERAL FUNDING PROVIDED TO THE STATES SHOULD BE SUFFICIENT TO ALLOW STATES TO ACHIEVE RATES THAT ARE COMPARABLE AND AFFORDABLE.

Ameritech suggests that the Commission should not accept the Joint Board's proposal because it might produce an increase in the amount of funding provided to the states by the federal fund.⁴² But Ameritech does not explain why the current amount of explicit federal funding is ideal, or indeed why Congress bothered to write Section 254 if

⁴² Ameritech at 4 and Attachment A. See also Joint State Commissions at 5, District of Columbia at 2.

it thought that no change in the current funding mechanism was needed. The new federal mechanism should provide sufficient resources to each state to allow that state to maintain affordable rates that are comparable to those in other states. The current high cost fund was not designed to identify the need for universal service funding, but rather was part of a package of policy measures adopted to mitigate the effects on different telephone companies of the adoption of the current 25% cost allocation factor for interstate loop costs. Further, and of particular importance in the context of a plan for non-rural companies, the current fund has always treated a larger ILEC less favorably than a smaller ILEC serving an otherwise similar area.⁴³ Thus, even if a comparison of average study area loop cost to a nationwide average were a good measure of the need for universal service funding (which it is not), there is no reason why this measure should match the amount of the current high cost fund since the current fund has a built-in bias as explained above.

Of course, the Joint Board proposes to use the distribution of estimated forward-looking cost across study areas, rather than the distribution of embedded cost, as the current high cost plan does. Without examining the final cost model estimates, it is difficult to assess how that difference might affect the results. As GTE pointed out in its comments, the size of the fund under the Joint Board proposal will largely reflect the

⁴³ Non-rural ILECs receive less than 20 percent of the current 1999 high cost fund because the universal service algorithms that favor smaller study areas. For example, the first band of qualifying loop cost for study areas greater than 200,000 lines receives only 10 percent support. In contrast, smaller study areas less than 200,000 lines receive 65 percent high cost fund support for the first band of qualifying cost.

dispersion of the cost estimates generated by the model.⁴⁴ The higher the variance of the means across study areas, the more dollars there will be above the benchmark, and the larger the fund will be.

However, as the Rural States explain, leaving aside the difference in the cost measures, there is every reason to expect that the estimated fund size under the Joint Board's proposal will exceed the level of the current fund. Today, the high cost fund provides very little support for larger, non-rural study areas. The Rural States point out that, for study areas above 200,000 lines, the incremental amount of loop cost supported is only 10%.⁴⁵ This is much less than the support a smaller company would receive (65 percent) for the same average cost level – and much less than the amount the Joint Board is seeking to measure in order to ensure comparable resource levels across states. The Rural States also show that the current mechanism provides no support for high switching cost to non-rural study areas, and no support at all for trunking cost. Thus, Ameritech's "showing" that the new fund will be larger than the old simply reflects the fact the existing fund discriminates against areas served by larger companies. If all areas in the country are to be treated in a comparable manner, then some increase in the funding provided will be necessary. GTE agrees with the Rural States that the new universal service program "should abolish all size-based

⁴⁴ GTE at 26.

⁴⁵ Rural States at 7.

distinctions, since these distinctions are not competitively neutral and disadvantage customers of larger carriers.”⁴⁶

VI. THE COMMISSION MUST ALLOW ALL CARRIERS TO RECOVER THEIR CONTRIBUTIONS.

The Joint Board acknowledges that contributions to the federal universal service mechanism may be based on both state and interstate retail revenues, and that the use of such a combined base may have significant advantages.⁴⁷ The Joint Board also recognizes that carriers should be able to recover their contributions through a separate line item on customer bills.⁴⁸ GTE strongly supports the use of a combined base of state and interstate retail revenues, and urges the Commission to ensure that all carriers – including ILECs – are allowed to recover their contributions from the customers whose purchases cause those contributions.

A. All Carriers Should Be Allowed To Recover Their Contributions From Their Retail Customers.

In order to assure that the federal universal service mechanism is competitively neutral, it is essential that the Commission allow all carriers to recover their contributions from their retail customers. For ILECs, who are not able to adjust their retail rates as other carriers are, this ability can only be assured if carriers are permitted to recover their contributions through a separate line item on the customer's bill. It is

⁴⁶ *Id.* at 8.

⁴⁷ Recommended Decision at ¶¶63.

⁴⁸ *Id.* at ¶¶69.

also essential that the base of revenues on which carriers are allowed to recover should match the revenues on which their contributions are calculated. Under the current federal universal service mechanisms, the ILECs are assessed for the high cost and low income fund components on the basis of their interstate retail revenues, and for the school and library and the rural health care funds on the basis of their combined state and interstate retail revenues. Yet ILECs are not allowed to pass these costs through to the customers who cause them; instead ILEC contributions to the federal funds are recovered through access charges.

Today, the retail consumers of telecommunications services ultimately pay all of the costs of those services – including the costs of universal service. This will be equally true under any new funding mechanism the Commission may adopt. The Commission should not distort the relative prices of different carriers' services in a misguided attempt to conceal from consumers what they really pay for universal service. The Recommended Decision notes that universal service assessments are a cost the firm faces, like any other cost.⁴⁹ The Commission has always championed the concept that rates should be cost-based. In this case, the cost-causer, from the carrier's standpoint, is the retail customer whose revenue triggered the carrier's contribution. It is entirely reasonable therefore, and consistent with the Commission's long-maintained pricing principles, that the carrier should align its recovery through rates with this cost which is directly attributable to the retail customer's purchase decision. Anything that forces a carrier to deviate from this form of recovery will distort

⁴⁹ Recommended Decision at ¶68.

the carrier's rates, relative to those for other services, and will unfairly shift the burden of recovery onto other consumers.

At the same time, GTE recognizes that the Commission has legitimate concerns with respect to the recovery of universal service contributions by carriers. The Joint Board expressed concern that carriers should not be able to unreasonably shift the burden of their contributions onto the shoulders of customers whose demand is less elastic.⁵⁰ It also voiced its concern that carriers should not misrepresent their universal service charges to end users.⁵¹ Given the Commission's recent experience with the passthrough of various charges, these concerns are not unreasonable.

As a safeguard against the possibility that carriers might recover a disproportionate share of their contributions from less price sensitive customers, the Joint Board recommended that a separate line item used by a carrier to recover its contribution should be no greater than the rate at which the carrier itself must contribute to the fund. GTE believes that this constraint is reasonable.⁵² However, objections to this safeguard have been raised by several parties. While GTE believes that these commenters raise valid concerns, GTE also suggests that these concerns can be fully addressed by correcting flaws in the administration of the fund.

⁵⁰ *Id.* at ¶169.

⁵¹ *Id.* at ¶170.

⁵² In fact, GTE believes that a mandatory surcharge would be the best recovery mechanism.

B. The Fund Should Be Administered On A “Real-Time” Basis To Ensure Competitive Neutrality.

Airtouch, for example, argues that the Commission’s current rules require a carrier to contribute to the fund based on its revenue in a prior period.⁵³ As a carrier’s demand level grows or shrinks during the period, its assessment will not be the same percentage of its current revenue. GTE agrees with Airtouch that this is a problem, and the problem is not merely a technical one for the firm of estimating the end user charge it will need to recover its contribution. The mismatch Airtouch describes will also lead to a lack of competitive neutrality, because the effective rate at which carriers are contributing within each period will depend on whether they are gaining or losing market share.⁵⁴ Consider, for example two carriers, A and B. A’s demand is constant, while B, a new entrant, is growing at 100% per year. If each carrier’s contribution is a fixed amount based on last year’s revenue, then the actual percentage of the line item charge B must assess within the year to recover its contribution will be only half the rate that A must charge. The solution Airtouch proposes – to allow carriers flexibility to set higher recovery charges – mitigates the purely mechanical problem of matching

⁵³ Airtouch at 2. See *a/so* PCIA at 4.

⁵⁴ See *a/so* AT&T at 9: “...given that USF assessments are based on historical revenues, carriers with declining revenues must recover their USF obligations from their customers at a rate higher than the assessment rate to fund their USF contribution amount.”

recovery to contribution, but not the more fundamental problem of competitive neutrality.⁵⁵

GTE suggests that a better way to address the concern raised by Airtouch would be to revise the way the fund is administered. As long as carriers' contributions are based on revenue from a prior period, there will always be a mismatch between the carrier's obligation and its current revenue, and the fund will never be competitively neutral. Instead, the fund administrator should manage the fund on something closer to a real-time basis. At any given time, the administrator would post the contribution percentage then in effect. Each carrier would remit to the fund that percentage times the carrier's actual revenue within each period. If the carrier, at any given time, is billing its customers at a rate no higher than the current assessment rate, then there will never be a mismatch between the obligation the carrier incurs within any given period and the amount it collects from its customers within that same period. The fund administrator would announce the time intervals at which the carriers must remit to the fund (e.g., quarterly, monthly) in order to manage the fund's cash flow. The administrator would also adjust the contribution rate as necessary over time to keep fund receipts in line with fund disbursements.⁵⁶ This approach is closer to the way pooling arrangements are typically administered in the industry today. It provides a more fundamental solution

⁵⁵ The Airtouch proposal does not ensure that the carrier will be able to avoid any mismatch between its universal service recovery and its contribution because its contribution is fixed in advance and it must estimate what percentage of its revenue will be needed to generate that amount.

⁵⁶ Any change in the contribution rate would have to be announced with enough lead- time to allow carriers to adjust their billing.

to Airtouch's concern than the remedy suggested by Airtouch.⁵⁷ It would ensure that the administration of the fund is competitively neutral. And it would meet Airtouch's objection, while still allowing the Commission to place an upper limit on carriers' universal service recovery in the manner suggested by the Joint Board.

C. The Calculation Of Carrier Contributions Should Take Reasonable Account Of Uncollectibles.

Several parties note that a carrier will not collect the entire amount it bills. If no account is taken of uncollectibles, and the carrier's recovery is limited to the contribution percentage times its billed revenue, then there will always be a shortfall in the carrier's recovery.⁵⁸ GTE agrees that this is a concern, but there are several options for addressing that concern that would still be compatible with the limit on carrier recovery proposed by the Joint Board. The fund administrator could make a standard allowance for uncollectibles when the contribution percentage is calculated. This would be simple, but would not recognize the fact that different carriers might have different levels of uncollectibles. An alternative would be to base contributions on collected revenues, rather than on billed revenue. A third alternative would allow each carrier to bill a higher percentage than the contribution rate, so long as the same percentage were applied to

⁵⁷ This proposal would allow a carrier to bill a fixed percentage and remit it to the fund in the manner suggested by MCI (at 21). AT&T makes a similar proposal (at 9) of a "simultaneous assessment and recovery mechanism that would be assessed against carriers' retail revenues and collected by carriers from their retail customers."

⁵⁸ AT&T at 9, MCI at 20, Sprint at 21.

all of the carrier's customers, and so long as the carrier could periodically (say, annually) reconcile the additional amount it had billed with its uncollectibles.

D. The Revenue Base Used For Assessing Carrier Contributions Should Be The Same Base Used For The Recovery Of Contributions.

Several interexchange carriers note that the access charges they pay today include recovery of ILEC contributions to the existing universal service fund. Sprint, for example, argues that it must have the ability to bill a line item to its retail customers which is larger than the contribution rate, to take account of this "flowback" from the ILECs.⁵⁹ However, as AT&T points out, if each carrier, including an ILEC, is able to recover its contribution from its own retail customers, then the concern over "flowback" would be eliminated, since there would be no recovery of ILEC contributions through access charges.⁶⁰ GTE agrees that if the base of funding is retail revenues, each carrier should recover its contribution only from its retail customers. Similarly, Sprint expresses concern that there might be some mismatch between the revenue base on which contributions are assessed and the base on which recovery is allowed. Sprint cites as an example as an example the current school and library fund; contributions to the fund are calculated on combined state and interstate retail revenue, but carriers are allowed to recover only through their interstate rates.⁶¹ GTE agrees that the revenue

⁵⁹ Sprint at 21. See also MCI at 18. Note that under the USTA proposal ILECs would no longer recover their universal service contributions through their access charges. This would reduce interstate access by about \$800 million per year.

⁶⁰ AT&T at 9.

⁶¹ Sprint at 19-20. Indeed, ILECs are only allowed to recover through their interstate access rates.

used for calculating carrier contributions should be consistent with the revenue base on which the carrier should be allowed to recover its contribution from its customers. This revenue base should be combined state and interstate retail revenues.

If a consistent base of retail revenues is adopted, as GTE has proposed, and if improvements are made to the administrative arrangements for the fund, along the lines discussed here, then all carriers should be able to recover their contributions from their retail customers. The recovery of contributions should be accomplished through a separate line item on the customer's bill. GTE believes that -- with the caveats discussed here -- it would be reasonable to limit each carrier's recovery to an amount no higher than its contribution rate. This constraint would assure the Commission that no customer would be unfairly burdened by a carrier's recovery on its universal service contribution.

VII. CONCLUSION

The Commission faces a significant challenge in developing its universal service plan. The success of the 1996 Act in promoting a competitive market, while preserving universal service, will depend in large part on whether the Commission is willing to accept its responsibility to adopt a funding mechanism that is competitively neutral, and sufficient to replace the current system of implicit subsidies. In particular, the Commission must act to replace the implicit subsidies generated today by interstate access charges. The framework presented by the Joint Board may be workable, but as yet it is only a vague outline. Time is short before the July implementation date for the new plan, and further delay would be unreasonable. The Commission therefore has

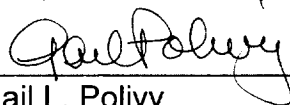
much to do in the coming months if it is finally to discharge the universal service responsibility assigned to it by Congress.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Judy R. Quinlan, hereby certify that copies of the foregoing "Reply Comments of GTE" have been mailed by first class United States mail, postage prepaid, on January 13, 1999 to all parties of record.



Judy R. Quinlan